

DIVISION OF TAX APPEALS

A hearing was held before Jean Corigliano, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on October 4, 1994 at 10:00 A.M. Petitioners and the Division of Taxation filed briefs on February 6, 1995 and May 1, 1995, respectively. Petitioners filed a reply brief on May 19, 1995, which began the six-month statutory period for issuance of a determination. Petitioners appeared by Gerard W. Cunningham, Esq. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Robert J. Jarvis, Esq., of counsel).

Whether petitioners have established that the Division of Taxation included in its calculation of taxable receipts for the

audit period certain receipts not subject to the sales tax imposed by Articles 28 and 29 of the Tax Law.

FINDINGS OF FACT

Petitioner Artex Systems, Inc. ("Artex") is a designer, manufacturer and installer of various architectural wall systems. Petitioner Grant Kafarowski started the company in 1962 and has been Artex's president since then. Artex is a Canadian corporation located in Ontario, Canada.

Following a field audit of Artex's business operations and sales tax returns, the Division of Taxation ("Division") issued to each petitioner a separate notice of determination for the period June 1, 1990 through August 31, 1992 assessing sales and use taxes in the amount of \$270,032.83, plus penalty and interest.

The Division issued to petitioners separate conciliation orders, dated October 1, 1993, sustaining the full amount of the tax assessment but cancelling all penalties. Petitioners then filed a joint petition contesting the full amount of the tax assessed. Petitioners paid all or part of the assessment after the conciliation orders were issued (the exact amount of the payment is unknown); consequently, cancellation of part or all of the assessment may result in a refund to petitioners.¹

¹At hearing, the parties were asked whether they could stipulate to the amount of the payment. The Division's representative stated that he was not sure of the relevance of that information, but he agreed that a payment had been made to stop the running of interest. Petitioners' representative offered to place a copy of the cancelled check in evidence, but this was never done. Based on the attorneys' comments, it may be presumed that the full amount of the tax assessment was paid, but this is not an absolute certainty.

Artex is primarily a subcontractor in the construction industry. It has fabricated and installed the outside facade for major building

projects in Canada, the United States, and the United Kingdom. The tax assessment at issue here resulted from work performed by Artex on one particular project in New York State, the Regent Hotel (later known as The Four Seasons) in New York City.

The construction manager of the Regent Hotel was Tishman Construction Corporation ("Tishman") and the architect was Pei, Cobb, Freed & Partners. On January 9, 1990, Artex submitted to Tishman a quotation (or bid) to supply "F.O.B. truck at designated marshalling yard exterior stone clad precast panels all for the sum of \$5,393,000.00" (Letter from J. D. Farwell, vice-president of Artex, to Joseph Cascino of Tishman Realty, January 9, 1990).

Tishman and Artex executed a contract, all or parts of which were revised on February 6, 1990, February 8, 1990, August 10, 1990, August 28, 1990, October 15, 1990, November 1, 1990 and January 4, 1991, respectively. Petitioners offered in evidence what appears to be the final version of the contract. The front page states:

"The Principal by and through its Agent, the Construction Manager, hereby gives to the Vendor an order for and the Vendor agrees to provide at the above Project, the materials described below, on the conditions stated below and on the reverse side hereof. *F.O.B. staging yard Stone Faced Precast Concrete in accordance with the following Contract Documents"

The "Stone Faced Precast Concrete" was described by

petitioners as precast concrete panels faced with a limestone veneer. Some of the panels were solid. Others contained openings for window and doors. Still others were shaped in the form of design moldings. Tishman purchased the limestone veneer in France. Artex cut and shaped the limestone and installed it as a veneer on the precast concrete panels.

Among the contract documents was Rider "A" which set forth with specificity the scope of the work to be performed by Artex. It contains this provision:

"Notwithstanding anything in the other Contract Documents to the contrary, all provisions of this addendum shall supersede any conflicting provisions of other Documents. All other provisions of the Contract shall remain in full force and effect."

The section of Rider "A" detailing the scope of work to be performed by Artex is just over four pages long. The scope of work provision begins with this statement:

"Without restricting the generality of work which shall be performed within the Contract Price, it is clearly understood and agreed that the Contractor shall provide all material, labor, trucking, engineering, in plant caulking, protection (to staging area), shop drawings, taxes, insurance, etc., necessary for the furnishing of all specified and related work contained herein in accordance with the Contract Drawings, Specifications, Addenda and Riders, all of which become part of this Contract."

As pertinent to this proceeding, the items to be provided by Artex were as follows:

- (a) the engineering and design of the stone faced precast concrete panels in accordance with the architect's concept and subject to the architect's approval;
- (b) the fabrication of the panels, including all material, labor and in-plant caulking;

(c) the provision of shop drawings and calculations demonstrating the structural adequacy of the precast system and attachment devices prepared by a professional engineer licensed in New York;

(d) the design, fabrication and drilling of stone holes and installing of stainless steel pins to attach the limestone veneer panels to the precast concrete;

(e) all supports and anchorage for installation of the stone faced panels;

(f) the services of a qualified representative, approved by Tishman, on the site project for the visual inspection of the panels and the installation of the panels for the first two weeks of the erection and on a periodic basis thereafter;

(g) delivery of the panels in accordance with a schedule to be agreed on by the parties;

(h) additional freight charges of \$35,000.00 for the transportation of the limestone, purchased in France by Tishman, from Montreal to Toronto; and

(i) a mock-up to include two spandrels, two column covers, two corners and two windows.

On the front page of the contract was a breakdown of the contract price as follows:

	"STONE FACED PRECAST CONCRETE	
	AMOUNT:	\$5,428,000.00
	TAX (on material portion)	265,000.00
	DUTY:	
122,000.00	TOTAL: (U.S. Dollars)	\$5,815,000.00"

On audit, the auditor was provided with 23 sales invoices,

each of which described the contract work as: "To supply only Limestone faced precast concrete." Upon review of the letter of January 9, 1990 from Artex to Tishman, the contract, change orders and the sales invoices, the Division determined that the contract was one for the sale of tangible personal property (stone faced precast concrete panels) and that all receipts relating to the contract were subject to sales tax.

To determine taxable receipts, the auditor initially created a worksheet listing 52 invoices with a reference number for each, the invoice date and number, the invoice amount, the taxable amount (in the auditor's estimation), tax paid as shown on the invoice, additional tax due per the auditor, and a description of the work or materials charged for as described on the invoice. The auditor's description of the work done falls into these categories: (1) handling of rejected pieces of limestone; (2) charges for lack of production due to lack of limestone; (3) cutting of limestone pieces; (4) container demurrage charges; (5) repair of a trailer; (6) manufacture and delivery of window panels; (7) finishing and cutting of limestone for the mock-up; (8) handling charge for rejected limestone pieces; (9) supply of limestone-faced precast concrete; and (10) supplying extra hardware and inserts. The worksheet shows that the auditor determined that the entire charge as shown on each invoice was taxable.² In his testimony,

²There is one exception to this statement. The worksheet shows an invoice amount of \$578,232.34 for invoice number 4705 and a taxable amount of \$502,527.34. There is no explanation for the difference. Other workpapers show that the entire amount of the invoice was determined to be subject to tax.

the auditor explained that he was later informed that some of the invoices were, in fact, change orders. These change orders added to the amount of the total contract price by charging for items or services not previously included in the contract amount of \$5,815,000.00; however, the change orders submitted by Artex were subject to Tishman's approval. After Tishman agreed to the change order, the amount of the change order was included in a sales invoice. The auditor eliminated all of the change orders from his calculation of taxable receipts, and this is reflected on the worksheet where the change orders have been crossed out. However, since the amounts of the change orders were included in the sales invoices after

Tishman's approval was received, the charges shown on the change orders were reflected in the auditor's calculation of taxable receipts.

The auditor calculated taxable receipts on the Tishman project based upon the 23 sales invoices provided to him by petitioners. Invoice 4728, dated December 18, 1991, is typical of the 23 sales invoice used by the auditor. Like the other invoices, it shows a calculation of balance due from Tishman beginning each time with the total value of the contract (\$5,815,000.00) and adding the value of change orders, approved and pending, to compute the total adjusted contract price. This is followed by a statement of the value of work completed to date, less previous billings, to compute the gross amount due on the invoice. The gross invoice amount is reduced by a 10%

retention to calculate a net balance due on the invoice. The auditor determined taxable receipts by aggregating the net balance due as shown on each of the 23 sales invoices issued during the audit period.

On each of the sales invoices entered into evidence (18 of the 23 relied on by the auditor), there is a handwritten notation which shows a calculation of the amount of New York State sales tax remitted under the contract. On invoice 4728, the calculation, beginning with the amount of sales tax included in the contract price, \$265,000.00, is as follows:

"NYS Tax 265,000.00
Job 90.2% complete

 NYS Tax
239,030.00
 remitted to date
226,840.00

12,190.00"

Based upon 23 sales invoices provided by petitioners, the Division determined that total charges subject to sales tax amounted to \$6,269,864.76. Based on a tax rate of 8.25%, the tax due on that amount would be \$517,263.83. The auditor found that Artex had reported purchases subject to use tax of \$3,294,179.00; however, he was unable to verify that payments had been made on three invoices (invoice numbers 4749, 4697 and 4758) with a total value of \$413,783.76. Tax paid by Artex was determined to be \$247,231.00 and additional tax due was determined to be \$270,032.83.

Both the exact amount of Artex's sales tax payments and Artex's method of computing tax shown on its sales tax returns

are in dispute.

Petitioners placed in evidence copies of cancelled checks, made payable to New York State, which show that Artex made payments of sales tax during the audit period in the amount of \$271,770.00. Petitioners claim that all of these payments relate to the Regent Hotel project and that credit should be given for their having paid sales taxes relating to that project in the same amount.

In an affidavit, the auditor stated that Artex was collecting and remitting sales tax for other projects in addition to the Regent Hotel project and that he was unable "to verify that petitioner paid tax in connection with the Tishman project for [invoice numbers 4749 and 4697]." As a consequence, the auditor concluded that Artex had not paid any sales tax on charges included on those invoices. In an answering affidavit, Mr. Kafarowski stated that the auditor's statements are not true and noted that there is no evidence in the record to support his allegation that Artex was collecting and remitting sales tax on projects other than the Tishman project.

Invoice number 4749 was placed in evidence. It shows New York State sales tax paid on the charges shown on that invoice as \$2,650.00. A cancelled check dated March 4, 1992, in the amount of \$2,650.00, correlates with invoice number 4749.

Invoice 4697 was not placed in evidence. Summary worksheets of both parties show the date of that invoice as January 23, 1991. A cancelled check in the amount of \$19,610.00, dated February 6, 1991, was placed in evidence. It verifies that a payment was

made to New York State on this date. Petitioners also proved, through submission of a cancelled check, that a payment of \$2,279.00 was made to New York State on August 7, 1990. This payment does not appear to relate to any one of the 23 sales invoices relied on by the auditor in determining taxable sales.

Explaining the method used by Artex to calculate the tax reported to New York, the auditor testified that Artex maintained an accrual account for "use" taxes. The same point is made on the cover page of the audit report which indicates that Artex reported no gross sales, no taxable sales and purchases subject to use tax of \$3,294,179.00. These statements are contradicted by page 5 of the "Field Audit Report-Attachment Sheet" which contains this statement: "It should be noted that the vendor did not report gross sales on his sales tax returns. Purchases subject to use tax were erroneously reported as taxable sales." Artex's sales tax returns were not offered into evidence. The documentary evidence indicates that Artex collected sales tax from Tishman and remitted the tax collected to New York.

Artex's billings to Tishman were prepared by Artex's vice-president, James D. Farwell, who explained through his testimony the billing documents showing the amount and nature of Artex's charges to Tishman. In addition to the sales invoices relied on by the auditor to calculate sales tax, Artex prepared and submitted to Tishman monthly requisitions on forms prepared by Tishman. Attached to each requisition was a packet of documents including all or some of the following: (1) a summary sheet;

(2) an affidavit averring that Tishman paid Artex in full in accordance with Tishman's current obligation under the contract; (3) an original copy of an Artex sales invoice; (4) a spreadsheet entitled "SUBCONTRACTOR WORKSHEET - SCHEDULE OF VALUES; (5) a worksheet listing pending change orders; and (6) a bill of sale with a schedule showing the actual number of pieces of precast concrete panelling sold and delivered to Tishman. Petitioners placed in evidence 25 packets of original documents for the Regent Hotel. They were provided to Artex by the present owners of the hotel. These 25 packets include requisition numbers 1 through 6, 6 (there are two requisitions with this number) through 13, 15 through 18, 38 through 42, a second requisition numbered 42, and one unnumbered requisition dated July 26, 1993. Other than the last two packets, they cover the period August 1990 through September 1992. The last two packets (the second requisition numbered 42 and the unnumbered requisition) are both dated July 1993 and contain final negotiations between Artex and Tishman or the owners of the Four Seasons Hotel regarding possible payments still owed to Artex.

The auditor stated in an affidavit, notarized on December 14, 1994, that "petitioner never provided me with either the originals or copies of the documents which have been offered into evidence as Exhibit 13" -- the requisitions and attached documents. However, at hearing, the auditor removed from his files a packet of documents which he identified as a "cost summary analysis" provided to him by petitioner on audit. It is

a copy of requisition number 41, dated July 15, 1992, with the documents attached thereto. This packet of documents was placed in evidence as Petitioner's Exhibit "1". The auditor stated that he did not consider any of these documents in arriving at a final determination of tax due.

The first requisition numbered 42 is for the quarter ending August 31, 1992 (the end of the audit period). It contains a subcontractor worksheet which shows, among other things, a breakdown of the original contract price of \$5,815,000.00 as follows:

Engineering and Design	\$	200,000.00
Florida Mock-up		50,000.00
Site Hardware (Inserts)		100,000.00
Forming		150,000.00
Production of Units		3,720,000.00
Shipping, Duty & Brokerage		1,170,000.00
New York State Taxes		270,000.00
Miscell. Finishing, Site Trips		120,000.00
Limestone Contingency		0.00
Extra Container Shipping Allowance		35,000.00

Each of the other requisition packets contains a subcontractor worksheet showing a similar breakdown of the contract price (numbers 1 through 3 are slightly different). In addition to a breakdown of the contract price, each subcontractor worksheet shows the value of the work completed to the date of the monthly requisition. There is a column on each worksheet reserved for Tishman's calculation of work completed to date. The figures in this column indicate Tishman's agreement or disagreement with Artex's computations.

There is a fair degree of consistency between the requisitions and the sales invoices relied on by the auditor to determine taxable sales.

For the most part, the invoice dates correlate with the dates on the requisitions. There are exceptions where there are duplicate requisition numbers (number 6), missing requisitions (number 14) and missing invoices (only 18 of the 23 invoices relied on by the auditor were entered in evidence). There is a discrepancy between the dates of the invoices and the requisitions for the months of June, July and August 1991.

The front page of each requisition shows a running calculation of the total amount of the contract calculated by adding the amount of the contract (\$5,815,000.00) to change orders issued to the date of the requisition, plus pending change orders. Each sales invoice shows the same calculation, and the monthly calculations on the sales invoices and requisitions are generally consistent even where the date of each is different (e.g., the sales invoice dated August 18, 1991 and the requisition dated August 30, 1991 have the same calculation of the total adjusted contract amount of \$6,182,972.53).

Many of the requisition packets contain an itemization of the number of panels delivered to Tishman to date and the number remaining to be delivered. The calculation of work completed to the date of the requisition reflects actual work done rather than an agreed upon percentage of the overall sale. For example, \$50,000.00 of the contract price was allocated to the Florida Mock-up. Requisition number 3 shows that this work was completed by October 1990 and the total value of \$50,000.00 appears as completed work on the contract cost breakdown sheet

attached to requisition number 3. In the same vein, requisition number 5 shows that a value of \$150,000.00 was allocated to the forming (wooden forms used to shape the concrete) and that 6 forms at a value of \$69,230.00 were completed by December 1990. The next month, 7 forms were completed at a value of \$80,269.50, and by April 1991, all work in this category was completed at a value of \$150,000.00.

Mr. Farwell testified regarding the manner in which the parties calculated a sales tax of \$270,000.00 as part of the contract price. He stated that Artex determined the total value of the precast concrete panels as follows:

Materials	\$1,100,000.00
Labor	1,225,000.00
Overhead on Plant Labor	<u>380,000.00</u>
Sub-total	2,705,000.00
Firm Overhead	<u>1,080,000.00</u>
Total Canadian Dollars	\$3,785,000.00

Mr. Farwell stated that overhead on plant labor consisted of amounts necessary to cover workers' compensation payments, health insurance, unemployment insurance and expenses of that nature. Firm overhead included fixed expenses of the firm, such as building costs, plus profit. The calculations were originally made in Canadian dollars and then converted to United States dollars of \$3,293,000.00. A tax rate of 8¼ percent was applied to the result to calculate sales taxes of \$271,670.00. The parties agreed to include in the contract price sales tax in the amount of \$265,000.00; however, documents submitted by petitioners show that the actual amount of tax collected from Tishman and paid to New York State was \$271,770.00.

It is petitioners' contention that the only receipts subject to sales tax are those representing materials, labor and overhead as shown above. They claim that all other items are for the sale of services or other items not subject to New York sales tax. Petitioners' evidence and arguments with regard to each item shown on the subcontractor worksheet will be examined separately.

(a) The contract required Artex to engineer a design for the precast concrete panels in accordance with the architect's plans and specifications. In addition, Artex was required to produce hundreds of pages of shop drawings and structural engineering calculations for review and approval by the architect, engineer and others. The amount attributed to the provision of these services according to the subcontractor worksheet(s) was \$200,000.00. Petitioners claim that these engineering services were not subject to sales tax.

(b) Artex produced what has been referred to as a Florida Mock-up, as provided for in section (c)(15) of Rider "A" of the contract. The "mock-up" actually consisted of a precast concrete panel which was over two stories high (approximately 30 feet). It was shipped from Canada to a testing facility in Florida where it was subjected to various tests to ensure that the panels would withstand stress from the building, wind and water. Under the terms of the contract, the costs of shipping the panels to Florida, including customs duties, were included in the contract price. The tests were conducted during the period November 30, 1990 through December 19, 1990 by an

independent laboratory. The panel was destroyed in Florida when the testing was completed. The subcontractor worksheet allocates \$50,000.00 of the total contract price to the Florida Mock-up. The concrete panel plus two barrels of loose hardware were shipped to Miami, Florida by Artex via Kalybaba Trucking, Inc. of Jordan, Ontario, Canada. Documents placed in evidence include a Kalybaba sales invoice, dated November 2, 1990, in the amount of \$14,000.00 for shipment of two loads from Ontario, Canada to Miami, Florida.

(c) Artex provided the hardware needed to install the precast concrete panels, although it did not perform the installation work. Artex did not include the charge for this hardware in its calculation of taxable receipts.

(d) The concrete panels were formed, in part, by pouring the concrete into wooden forms designed and built by Artex for this purpose. After the forms were used, they were discarded. Artex did not include the charge for the forms in its calculation of taxable receipts, apparently on the theory that the forms were not transferred to Tishman.

(e) Petitioners submitted four packets of shipping documents (including the documents evidencing the shipment made to Florida). These documents include carbon copies of checks made payable to Kalybaba, Kalybaba sales invoices and shipping documents. They establish that between November 2, 1990 and April 18, 1991 Kalybaba provided transportation services to Artex consisting of shipping precast concrete panels and related hardware to Tishman in New York or Florida. The total charge to

Artex for these services was \$63,692.67.

(f) The first page of the contract shows that the sum of \$122,000.00 was included in the contract price for customs duties. In addition, Artex retained the services of a customs broker to calculate the amount of Customs duties owed to the United States government.

(g) The first page of the contract also shows that the parties agreed to include sales tax in the total contract price. At the time the final version of the contract was executed, the amount agreed to was \$265,000.00. The amount of sales tax actually collected by Artex and remitted to New York was \$271,770.00.

(h) The contract includes an allowance of \$35,000.00 for additional freight charges from Montreal to Toronto. Tishman purchased the limestone used to fashion the limestone veneer in France. Artex agreed to arrange for shipment of the limestone from Montreal to Toronto. The allowance of \$35,000.00 was intended to cover Artex's costs and was contingent upon Artex taking responsibility for these arrangements. The allowance was included in the total contract price.

Mr. Farwell testified that change orders agreed to by both parties added \$639,594.60 to the total contract price of \$5,815,000.00. Thus, the total paid to Artex under the contract was \$6,454,594.60. Mr. Farwell testified that it was his understanding that the auditor included the full amount of the change orders in his calculation of taxable sales. However, the auditor's workpapers show that he calculated taxable sales for

the audit period of \$6,269,864.76, \$184,699.90 less than the total value of the contract. It may be that some of the change orders were paid after the end of the audit period and not included in the auditor's calculations; however, the record is unclear on this point.

One of the terms of the contract called for Artex to retain the services of a professional engineer licensed in New York State to perform certain calculations and to approve Artex's engineering designs. Artex retained the services of Raphael Bassan, a consulting engineer, to satisfy this contract term. During the period May 1990 through January 1993, Artex paid Mr. Bassan \$45,330.00 for his services. In addition to approving Artex's designs, those services included on-site inspection of the installation of the precast concrete panels. Under the original contract terms, an Artex representative was to be on-site for the first two weeks of the installation and periodically thereafter. The parties later agreed to have Mr. Bassan present during most of the installation period. Mr. Farwell testified that additional charges for Mr. Bassan's fees appear as part of the change orders included in the auditor's determination of taxable sales. However, the change orders evidencing the extension of Mr. Bassan's services were not placed in evidence and petitioners did not point to any documentary evidence which would enable one to determine which portion of Mr. Bassan's overall fee was allocated to overseeing installation of the panels.

SUMMARY OF THE PARTIES' POSITIONS

Petitioners claim that the assessment should be cancelled because they have demonstrated that the audit was fundamentally flawed. They contend that the auditor's procedures were inadequate and that his testimony "revealed such total confusion and inconsistency in his audit activity as to negate the result" (Petitioners' brief, p. 5). It is petitioners' position that the auditor misunderstood the nature of the contract, ignored billing documents which were available at the time of the audit and made only a cursory review of Artex's books and records.

Petitioners claim that they have adequately documented that the Tishman contract was for both tangible personal property subject to sales tax and services and other items not subject to sales tax. Moreover, they claim that, through a combination of testimony and documents, they have established the amount charged Tishman under the contract for each nontaxable item. Petitioners maintain that Artex separately stated the amounts billed for taxable and nontaxable items and that their billing documents were available at the time of the audit.

It is the Division's position that the contract was for the furnishing of precast concrete panels at a single sales price. The Division contends that all tasks set forth in the contract (such as engineering, design, shipping and handling) were an integral part of furnishing the panels and as such "were part of the overhead involved in selling the panels, just as expenses for engineering, testing, etc. incurred by an automobile manufacturer are part of the overhead of selling a

car" (Division's brief, p. 5).

The Division argues that the requisitions are simply backup documents and do not constitute proof that the parties agreed to separate payments for various taxable and nontaxable items. The Division describes the requisitions as progress billings "with the separation into tasks being only for the purpose of demonstrating that sufficient work had been performed to justify what was essentially an advance against the moneys to be paid upon delivery of the panels" (Division's brief, p. 9). It is the Division's position that the entire amount shown on each Artex invoice is subject to sales tax because the invoices did not separately state taxable and nontaxable items.

CONCLUSIONS OF LAW

A. I do not agree that the Division's audit was so inadequate as to require the cancellation of the assessment. It is well established that before resorting to an indirect audit method the Division must first request and thoroughly examine the taxpayer's books and records for the entire audit period (Matter of Adamides v. Chu, 134 AD2d 776, 521 NYS 826, 828, lv denied 71 NY2d 806, 530 NYS2d 109). Here, the Division conducted an audit that calculated the tax due based upon sales invoices provided by petitioners. It did not utilize an indirect audit methodology. The auditor based his conclusion that all receipts were for the sale of tangible personal property on his review of the contract, bid documents and sales invoices, and he calculated the tax due accordingly. Apparently, he was provided with at least one requisition

packet, but viewed the details included in it as merely costs incurred by Artex to produce the architectural panels. This evidence does not show that either the methodology employed or the determination that the contract was one for the sale of tangible personal property was irrational or unreasonable. Accordingly, the burden was upon petitioners to show that the amount of tax assessed was erroneous (Matter of Surface Line Operators Fraternal Org. v. Tully, 85 AD2d 858, 859, 446 NYS2d 451, 453).

B. Before I consider whether petitioners proved that there were contract items which should not have been included by the Division in its calculation of taxable receipts, I will address the Division's claim that the requisitions do not provide reliable evidence of what was sold by Artex to Tishman or of the amount charged for individual items.

The Division makes two arguments to support its claim. First, the Division states that the requisition documents and the testimony of petitioners' witnesses are a form of parol evidence which "should not be considered competent or persuasive" (Division's brief, p. 7). Application of the parol evidence rule is inappropriate in this proceeding.

The "parol evidence" rule may be invoked in court proceedings to exclude testimony and extrinsic writings which are offered to vary or contradict the terms of a written instrument which is clear on its face (Farm Stores v. School Feeding Corp., 79 AD2d 504, 433 NYS2d 453, affd 53 NY2d 910, 440 NYS2d 633). Neither the testimony of petitioners' witnesses nor

the requisitions were offered to vary or contradict the terms of Artex's contract with Tishman. They were offered merely as evidence of the receipts collected by Artex under the terms of the contract. In addition, the parol evidence rule is generally available for use only by one of the parties to a written agreement against another, although it may also be invoked by a third party clearly intended to be a beneficiary of the contract (see, Matter of SIN, Inc. v. Dept. of Fin. of the City of New York, 126 AD2d 339, 513 NYS2d 430 [where the court held that the Department of Finance erroneously applied the parol evidence rule by failing to give consideration to the uncontroverted testimony of the parties to a written lease regarding agreements not included in the lease]). Obviously, the Division was not intended to be a beneficiary of the contract between Artex and Tishman. Consequently, it would be an error for me to exclude from my consideration the testimony and documentary evidence offered by petitioners.

Second, the Division takes the position that the 23 Artex sales invoices are the only documents which may be considered in determining the taxable status of Artex's charges to Tishman under the contract. Inasmuch as the sales invoices do not identify individual items sold, the Division maintains that the entire charge shown on each sales invoice is subject to sales tax. The Division claims that the requisitions, including the subcontractor worksheets, do not show a separate statement of taxable and nontaxable items as required by the Tax Law. Rather, the Division claims, the requisitions were merely

progress billings by which "Artex was justifying to [Tishman] that it had earned the portion of the sale price that [Tishman] was being requested to pay" (Division's brief, p. 8). This argument is also rejected since I can find no basis for ignoring the requisitions as the Division urges me to do.

Every person required to collect tax is required to maintain records of every sale and of the amount charged and the tax payable on the sale (Tax Law § 1135[a][1]). "The records must contain a true copy of each . . . sales slip, invoice, receipt, contract, statement or other memorandum of sale" (20 NYCRR 533.2[b][1][i]). Either the sales records themselves must contain sufficient detail to independently determine the taxable status of each sale or supporting records must be made available by which the taxable status of each sale may be determined (20 NYCRR 533.2[b][2]). Here, Artex's sales records consisted of the contract of sale, the sales invoices, change orders, and the requisitions. All of these are relevant documents which must be considered in determining the taxable status of Artex's charges to Tishman.

Contrary to the Division's claim, the requisitions separately state Artex's charges for work performed under the contract, as that work was completed. The requisitions are quite specific concerning the nature of the work completed and the charge for that work. For example, the monthly requisition forms show such items as the number of forms built, the number of panels manufactured and delivered, and the shipping, handling and brokerage fees incurred. The Division's claim that there is

no evidence that Tishman agreed to the charges as shown on subcontractor worksheets is contradicted by the evidence. The requisition forms are Tishman forms which Artex was required to prepare in order to collect payment for work completed. There are separate spaces on the forms for Tishman's own calculations, and it is apparent from a cursory review of the forms that Tishman's agreement with the requisition was required before payment was made.

In sum, I find that the testimony of Mr. Kafarowski and Mr. Farwell was credible and relevant to the issues presented by the parties, and that the testimony and the requisitions constituted probative evidence of the taxable status of the goods and services sold by Artex to Tishman. The next issue is whether, or to what extent, this evidence shows that the Division imposed sales tax on charges not subject to sales tax pursuant to Article 28 of the Tax Law.

C. Section 1105(a) of the Tax Law imposes the sales tax on "receipts from every retail sale of tangible personal property". The Division takes the position that the contract between Artex and Tishman was for the sale of tangible personal property, including shipping and handling charges, and that all receipts collected by Artex under the terms of the contract were subject to the tax imposed under Tax Law § 1105(a). Petitioners proved that various contract items were not subject to sales tax and were erroneously included by the Division in its calculation of taxable receipts.

The auditor erroneously included sales tax paid over to New

York State in his calculation of receipts subject to sales tax. A plain reading of the front page of the contract establishes that sales tax in the amount of \$265,000.00 was separately stated as a component of the total contract amount. There is no evidence to support the auditor's conclusion that Artex accrued "use" tax on its purchases of materials. Rather, the sales invoices and requisitions show that Artex collected sales tax on its sales to Tishman on a monthly basis and remitted that tax to New York State. Cancelled checks show that Artex made sales tax payments totalling \$271,770.00 during the audit period. The evidence does not support the auditor's claim that some of these payments may have related to other jobs performed in New York State by Artex. There is no mention in the audit report or in the auditor's testimony of any job performed during the audit period which required Artex to collect and pay over sales tax to New York State. The Division offered no evidence to show that Artex paid sales tax during the audit period in connection with any other New York project. The lack of any such evidence adds credibility to Mr. Kafarowski's claim that all taxes paid by Artex during the audit period related to the Tishman project. Accordingly, taxable receipts shall be reduced by the amount of the sales tax payments, \$271,770.00. In determining the amount of tax due, the Division shall credit petitioners for payments in this amount.

The evidence also shows that customs duties in the amount of \$122,000.00 were included in the original contract price. Like the sales tax, this item is separately stated on the face of the

contract, and it should not have been included in taxable receipts. The auditor's calculation of taxable receipts shall be reduced accordingly.

Rider "A" of the contract required Artex to fabricate a mock-up of a precast concrete panel to be used for laboratory testing. The subcontractor worksheets show that \$50,000.00 of the total contract price was allocated to the Florida Mock-up, and that the work was completed and payment for the mock-up was requested in October 1990. The sales tax is a "destination" as well as a transaction tax; the point of delivery controls both the tax incident and the tax rate (20 NYCRR 525.2[a][3]). Since the the mock-up was manufactured in Ontario, Canada and delivered to Tishman's representatives in Florida, the receipts for the sale of the mock-up, \$50,000.00, were not subject to New York sales tax. Likewise, Kalybaba's charge of \$14,000.00 for transporting the panels to Florida was not includable in New York receipts.

Rider "A" of the contract also included a \$35,000.00 allowance from Tishman to Artex to arrange for transportation of Tishman's limestone from Montreal to Toronto. The requisitions show that the \$35,000.00 allowance was paid under the terms of the contract. This amount should not have been included in taxable receipts.

D. Petitioners have not established that any other receipts were erroneously included in the calculation of taxable receipts.

I agree with the Division that costs incurred by Artex for

the fabrication of the precast concrete panels were items of overhead, or expense items. The receipts from the sale of tangible personal property cannot be segregated into taxable materials and nontaxable services required to produce the tangible personal property. Design and engineering services, shop drawings, engineering calculations, specially constructed forms for shaping the panels and hardware for installing them were all integral components of the process of producing the precast concrete panels. The separate statement of these charges could not transform expense items into nontaxable services (see, Matter of Zagoren, Tax Appeals Tribunal, May 19, 1994).

As petitioners note, prior to September 1, 1991, section 1101(b)(3) of the Tax Law excluded from taxable receipts "the cost of transportation of tangible personal property sold at retail where such cost is separately stated . . . on the bill rendered to the purchaser." Here, the cost of transporting the precast concrete panels from Ontario to New York was not separately stated on a bill rendered to Tishman. The contract does not allocate a portion of the total amount to transportation. The requisitions lump together "shipping, duty and brokerage" charges. Petitioners have not offered any reliable methodology which would enable me to segregate shipping charges from charges for customs duty and brokerage fees. The Kalybaba invoices show the expense incurred by Artex for transportation, prior to September 1, 1991. They do not show the amount charged Tishman for transportation. Petitioners have

not suggested a method by which the shipping costs can be computed from the requisitions, the sales invoices, the contract or any combination of the three (see, 20 NYCRR former 525.5[g]). Consequently, petitioners have not shown that they were entitled to exclude transportation costs from taxable receipts.

Under the terms of its contract, Artex engaged the services of a New York licensed engineer to provide calculations demonstrating the structural adequacy of the precast concrete panels and to oversee the installation of the precast concrete panels at the beginning of the construction project. I believe that these services were an item of expense incurred by Artex in producing the panels. Moreover, there is no evidence that Artex separately billed Tishman for the services of the New York engineer; rather, his services appear to have been included in the general category of engineering services.

The New York engineer was engaged to oversee the installation of the precast concrete panels. Under the contract, these services were to be provided only during the initial stages of installation. Even if this was a nontaxable service, it does not appear that Artex imposed a separate charge for it. It seems to have been included in the \$200,000.00 charge for engineering services. Since the charge was not separately itemized, there is no basis for reducing taxable receipts to account for it.

The evidence establishes that Artex and Tishman later decided to retain the New York engineer for the entire installation period. Mr. Farwell testified that change orders

were issued by which Artex charged Tishman for these services. Assuming that the charges for such services were not subject to sales tax, it is not possible to determine the amount included in audited taxable receipts attributable to such charges. Petitioners have not produced the change orders or offered any other method for determining the exact amount charged Tishman for these services. Accordingly, petitioners have not carried their burden of showing that charges for the New York engineer's services were erroneously included in taxable receipts.

E. The petition of Artex Systems, Inc. and Grant Kafarowski, as officer, is granted to the extent indicated in Conclusion of Law "C"; the notices of determination issued for the period June 1, 1990 through August 31, 1992 (as modified by the conciliation orders) shall be modified accordingly; the Division shall determine any refund due as a result of this determination (see, Finding of Fact "3"); and in all other respects the petition is denied.

DATED: Troy, New York
November 9, 1995

/s/ Jean Corigliano

ADMINISTRATIVE LAW JUDGE